



Department of the Treasury  
Internal Revenue Service  
P.O. Box 2508  
Cincinnati, OH 45201

Release Number: **201545029**  
Release Date: 11/6/2015  
UIL Code: 501.32-00  
501.32-01  
501.33-00

Date: August 12, 2015  
Employer ID number:  
Contact person/ID number:  
Contact telephone number:  
Form you must file:  
Tax years:

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



Department of the Treasury  
Internal Revenue Service  
P.O. Box 2508  
Cincinnati, OH 45201

Date: June 16, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = State

C = Date

x = Number

y = Number

**UIL:**

501.32-00

501.32-01

501.33-00

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

**Issues**

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons described below.

**Facts**

You were incorporated in B on C. Your Articles of Incorporation specifically state:

- Said organization is exclusively organized for charitable, religious, educational and scientific purposes including for such purposes the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code or the corresponding section of any future federal tax code. The business activity for said organization is as follows: Fundraising for the purpose of children's education; to set up a social network for children in order to further their future educational funding. Developing and maintaining a website and other networks and systems for the furthering of children's education with the intent of helping children develop and manufacture creative projects for licensing and sale. Funds from this activity go directly into the running the organization and the website and into trusts or accounts for the children involved. Said monies to be used for the development of the system and tuition and expenses of the children's future education needs. The raising of funds for children's various charitable organizations as well as the development of said organizations and/or the partnering of the organization with other charitable organizations which focus on children,

their creative process and the development of their mental and inventive skills with a focus on helping them become entrepreneurs.

You are dedicated to the following three principals:

1. Children's brilliant ideas created with love.
2. Entrepreneurship at an early age.
3. Helping to fund children's continuing education.

Your main activity will be to develop and maintain a website and a system of production and licensing dedicated to the support, guidance, education and entrepreneurship of children. The website will be a secure social networking site for children which will be dedicated to teaching children how to deal with bullying of all types, at the same time protecting them from on-line bullying. In addition, the website will act as a protected social network for children who will be engaged in displaying their ideas, art, designs, and other creative endeavors to one another and the on-line computer community. The ideas and projects will be voted upon by members of website (children only) and then the projects with the majority of votes will be turned into real-world products. Products may include, but not be limited to: clothing, art, literature, music, practical inventions, handbags, mouse pads, mugs, and backpacks. For example, a tee shirt design voted as best among the constituents of the social network, will then be printed on tee shirts and sold.) You will then act as a licensing agency for these child designed products, offering them to the manufacturing and retail community for sale to the general public. You will hold the licenses for the products created by children for a period of two years. The intellectual property associated with these products, films, music, or inventions will always be held in perpetuity by the creator and not by you, unless the creator wants to sell or donate said copyright, patent, etc. After the two year period the copyright will revert to the creator.

Most of the profits (x%) from such designs will be put into a conservatorship type account and held for that child's further college education, which they will receive when they enroll in college or come of age. The remainder (y%) will be retained by you for your operations including web site maintenance.

You have a four member board who will also act as business mentors to the children, guiding them through the process of self-expression, invention, innovation, production and sales of their ideas.

Your startup costs and website design will be funded by charitable fundraising, grants and donations; your operating funds will mainly come from producing, marketing and selling the winning projects. You will also accept gifts, grants and contributions as well as link up with other children's charities and put on sponsored events, attractions and fundraisers.

#### **Law**

Section 501(c)(3) of the Code provides for exemption from federal income tax of organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1 (b)(1)(i) of the Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes; and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

Rev. Rul. 66-104, 1966-1 C.B. 135 holds that an organization which makes funds available to authors and editors for preparing teaching materials and writing textbooks, and, under the terms of the contract with the publisher, receives royalties from sales of the published materials and then shares them with the editors and authors, does not qualify for exemption under section 501(c)(3).

In Better Business Bureau of Washington, D.C. Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number of importance of truly exempt purposes.

In Binger v. Johnson, 394 U.S. 741 (1969), the Supreme Court stated that to be excluded from gross income under section 117, scholarships must be "relatively disinterested, no strings educational grants, with no requirements of any substantial quid pro quo from the recipients."

In Miss Georgia Scholarship Fund, Inc. v. Commissioner, 72 TC 267 (1979), the Tax Court held that a separate fund created by the Miss Georgia Pageant solely to award scholarships to the pageant's contestants, did not qualify under section 501(c)(3) of the Code because the scholarships were awarded in consideration of contractual obligations. The contract required contestants to participate in the Miss Georgia Pageant and appear in public as directed by pageant officials. A winning contestant who failed to honor the contract forfeited all rights to her "scholarship." The Tax Court concluded that the "scholarships" were compensation for signing the pageant contract and for performing services under it. Therefore, these awards were not section 117 scholarships and the fund was not operated exclusively for section 501(c)(3) purposes.

In Easter House v. United States, 12 Cl.Ct. 476, 487 (1987), citing section 1.501(c)(3)-1(d)(1)(ii) of the regulations, aff'd without opinion, 846 F.2d 78 (Fed.Cir.1988) that an organization is not operated exclusively for exempt purposes if it serves a private rather than a public interest.

### **Application of law**

You are not as described in section 501(c)(3) of the Code because you are not exclusively organized and operated for charitable purposes.

You are not as described in Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you fail both the organizational and operational tests.

You do not meet the requirements in Section 1.501(c)(3)-1(b)(1)(i) of the Income Tax Regulations. Your Articles of Incorporation state in part: "The business activity for said organization is as follows: Fundraising for the purpose of children's education; to set up a social network for children in order to further their future educational funding. Developing and maintaining a website and other networks and systems for the furthering of children's education with the intent of helping children develop and manufacture creative projects for

licensing and sale". Because you are organized to conduct the business activities listed above, your purposes are outside the parameters of 501(c)(3) purposes and you fail the organizational test.

You are not described in Section 1.501(c)(3)-1(c)(1) of the Regulations because more than an insubstantial part of your activities is not in furtherance of an exempt purpose; for example, you are operating for the private purposes of your contest winners, because you are providing them a means to market and sell their products in which they keep x% of the proceeds to be put into an account for education. You are also operating for substantial commercial purposes such as the marketing and sale of products because you are keeping y% of the proceeds of product sales to fund the commercial like services you provide to the winners.

You are not as defined in Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations, because you are operating for the private interests of the contest winners. For example, you will hold the licenses of the products created by the winners for a period of two years but the intellectual property associated with these products will always be held in perpetuity by the creator unless the creator wants to sell or donate the intellectual property rights. You also plan to pay the winner to license the product and utilize the copyright or patent. This shows you are a vehicle for promoting the sale of the winners' work which serves the private purposes of the winners.

You are similar to the organization in Revenue Ruling 66-104 because you pay royalties on a percentage basis for the products you sell on behalf of the winners; the winners will retain x% and you keep y% for the services you provide. Like the organization in the revenue ruling you are operating in a commercial manner.

You are similar to the organization described in Binger v. Johnson, because you are providing compensation to your participants and not scholarships. For example, contest winners will receive payments to an educational trust in their name based on subsequent sales of the winning products.

You are similar to the organization described in Miss Georgia Scholarship Fund, Inc. v. Commissioner, because the funds placed in the winners' individual trust accounts for future education needs serves as compensation for the products you sell on their behalf. Therefore, these awards are not section 117 scholarships and you are not operating exclusively for section 501(c)(3) purposes.

You are like Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279, in that you are not "operated exclusively" for exempt purposes. Although you may have some charitable purposes, your purposes include substantially furthering the private interests of the contest winners by providing them commercial like services as well as paying them royalties to fund their future education. Like the organization in this court case and in Easter House, this single nonexempt purpose destroys your claim for exemption under section 501(c)(3) of the Code.

### **Your position**

You state that you operate exclusively for educational and charitable purposes for qualifying for exemption section 501(c)(3). You believe setting up educational trust funds for contest winners by producing and selling winning entries qualifies for exemption as educational.

### **Our response to your position**

You failed to provide any additional information from which it can be concluded that your activities exclusively further or advance a purpose described in Section 501(c)(3). Further, the details as analyzed previously, show you are serving substantial commercial and private purposes.

## Conclusion

Based on the information you provided, your operations result in substantial private benefit to the creators of products and you are providing services in a commercial manner. As a result, we are not able to conclude that you are operated exclusively for public rather than nonexempt purposes. Despite any charitable and educational purposes your activities may achieve, you cannot qualify for tax exemption because more than an insubstantial part of your activities is not in furtherance of exempt purposes.

Accordingly, you do not qualify for exemption under section 501(c)(3) of the Code.

## If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

### **For an officer, director, trustee, or other official who is authorized to sign for the organization:**

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

### **For authorized representatives:**

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

**Where to send your protest**

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

**If you agree**

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at [www.irs.gov/formspubs](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Director, Exempt Organizations

Enclosure:  
Publication 892